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<u>Via Overnight Mail</u>

December 30, 2003

Thomas M. Dorman, Esq.
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40602

Re: **<u>Case No. 2003-00334 and 2003-00335</u>**

Dear Mr. Dorman:

Please find enclosed the original and twelve copies each of Kentucky Industrial Utility Customers, Inc. Responses to LG&E/KU's Initial Request for Information dated December 16, 2003, and the Commission Staff's First Set of Data Requests dated December 16, 2003 filed in the above-referenced matters.

By copy of this letter, all parties listed on the attached Certificate of Service been served. Please place this document of file.

Very Truly Yours,

Michael L. Kurtz, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Attachment
cc: Certificate of Service
Richard Raff, Esq. (via electronic mail)

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by mailing a true and correct copy, by regular U.S. mail (unless otherwise noted) to all parties on the 30th day of December, 2003.

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Michael L. Kurtz, Esq.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

AN INVESTIGATION PURSUANT TO KRS 278.260	)	
OF THE EARNINGS SHARING MECHANISM)		
TARIFF OF KENTUCKY UTILITIES COMPANY	)	**CASE NO. 2003-0334**
	)	
AND	)	
AN INVESTIGATION PURSUANT TO KRS 278.260	)	
OF THE EARNINGS SHARING MECHANISM	)	**CASE NO. 2003-0335**
TARIFF OF LOUISVILLE GAS AND	)	
ELECTRIC COMPANY	)	

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO LOUISVILLE GAS & ELECRIC COMPANY'S
AND KENTUCKY UTILITIES COMPANY'S
INITIAL REQUEST FOR INFORMATION
DATED DECEMBER 16, 2003

1. If the Earning Sharing Mechanism ("ESMs") are continued, explain why it would not be appropriate for the Commission to modify the ESM to include an upper and lower threshold for earnings and/or return on equity?

RESPONSE:

Mr. Kollen has not proposed a change in the structure of the ESMs, should they be continued. Mr. Kollen believes that the ESMs should "include an upper and lower threshold for earnings and/or return on equity."

COMMONWEALTH OF KENTUCKY

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TARIFF OF KENTUCKY UTILITIES COMPANY	)	**CASE NO. 2003-0334**
	)	
AND	)	
AN INVESTIGATION PURSUANT TO KRS 278.260	)	
OF THE EARNINGS SHARING MECHANISM	)	**CASE NO. 2003-0335**
TARIFF OF LOUISVILLE GAS AND	)	
ELECTRIC COMPANY	)	

KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO LOUISVILLE GAS & ELECRIC COMPANY'S
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INITIAL REQUEST FOR INFORMATION
DATED DECEMBER 16, 2003

2. According to Mr. Kollen, why is incentive compensation not included as a recoverable expense under the ESMs?

RESPONSE:

According to the Companies, they have not included short-term incentive compensation expense in their ESM filings. Mr. Kollen recommends no change in this practice. Further, Mr. Kollen is opposed to including such costs in the ESM filings or in any other form of ratemaking recovery for the reasons cited on pages 20 and 21 of his testimony.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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AN INVESTIGATION PURSUANT TO KRS 278.260	)	
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TARIFF OF KENTUCKY UTILITIES COMPANY	)	**CASE NO. 2003-0334**
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AN INVESTIGATION PURSUANT TO KRS 278.260	)	
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ELECTRIC COMPANY	)	

**KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
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INITIAL REQUEST FOR INFORMATION
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3. Did LG&E ratepayers benefit from a combination of a base rate decrease and annual ESM rate decrease for calendar year 2000?

RESPONSE:

Ratepayers benefited from the base rate reduction ordered by the Commission in 2000. Ratepayers benefited from the ESM rate reduction based on the 2000 test year in 2001 and 2002.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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AN INVESTIGATION PURSUANT TO KRS 278.260 OF THE EARNINGS SHARING MECHANISM TARIFF OF KENTUCKY UTILITIES COMPANY	**))) CASE NO. 2003-0334)**
AND	**)**
AN INVESTIGATION PURSUANT TO KRS 278.260 OF THE EARNINGS SHARING MECHANISM TARIFF OF LOUISVILLE GAS AND ELECTRIC COMPANY	**)) CASE NO. 2003-0335))**

**KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO LOUISVILLE GAS & ELECRIC COMPANY'S
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DATED DECEMBER 16, 2003**

4. If base rate changes are not annualized as if they were in effect the entire year for ESM purposes, would the earnings available for sharing include the impacts already reflected in the base rate change?

RESPONSE:

Mr. Kollen is unable to answer the question because of insufficient information. The question does not identify the costs in the test year for setting base rates or the costs in the 2004 test year for ESM purposes or provide a reconciliation between the costs in the two test years.

COMMONWEALTH OF KENTUCKY

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TARIFF OF KENTUCKY UTILITIES COMPANY	)	**CASE NO. 2003-0334**
	)	
AND	)	
AN INVESTIGATION PURSUANT TO KRS 278.260	)	
OF THE EARNINGS SHARING MECHANISM	)	**CASE NO. 2003-0335**
TARIFF OF LOUISVILLE GAS AND	)	
ELECTRIC COMPANY	)	

**KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
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INITIAL REQUEST FOR INFORMATION
DATED DECEMBER 16, 2003**

5. If base rate changes are not annualized, would the impacts of the base rates and ESM rates overlap?

RESPONSE:

Yes. The extent to which the "impacts" would overlap depends upon whether the ESM is continued, or if not continued, the effective date of the ESM termination.

COMMONWEALTH OF KENTUCKY

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TARIFF OF KENTUCKY UTILITIES COMPANY	)	**CASE NO. 2003-0334**
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KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO LOUISVILLE GAS & ELECRIC COMPANY'S
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INITIAL REQUEST FOR INFORMATION
DATED DECEMBER 16, 2003

6. Does the annualization of base rate changes as if they were in effect the entire year provide equitable earnings available for sharing in the ESM?

RESPONSE:

Yes. First, it is consistent with the Commission's annualization of the rate reduction in the first ESM test year. Thus, there is symmetry and equity between the initiation and termination of the ESM. Second, it provides for an orderly and equitable transition from the ESM back to traditional regulation.

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TARIFF OF LOUISVILLE GAS AND	**)**
ELECTRIC COMPANY	**)**

**KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO COMMISSION STAFF'S
FIRST SET OF DATA EQUEST
DATED DECEMBER 16, 2003**

1. Refer to the Direct Testimony of Lane Kollen ("Kollen Testimony"), pages 10 and 11. Does Mr. Kollen believe the Earnings Sharing Mechanism ("ESM") is an alternative form of regulation or a supplemental for of regulation? Explain the response.

RESPONSE:

Mr. Kollen believes that the ESM was offered by the Commission to the Companies as an alternative form of regulation, not a supplemental form of regulation. Mr. Kollen's belief is based on the Commission's Orders in Case Nos. 98-426 and 98-474, wherein there was extensive discussion regarding the trend away from traditional regulation, the Commission's experience in alternative regulation in the telecommunications arena, and the specific statements that "[The Commission will now offer LG&E [KU] an alternative to traditional regulation in the form of an optional ESM plan." The Companies chose the optional ESM plan. The Commission did not offer an optional ESM plan in addition to traditional regulation.

COMMONWEALTH OF KENTUCKY

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TARIFF OF KENTUCKY UTILITIES COMPANY	**) CASE NO. 2003-0334**
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KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO COMMISSION STAFF'S
FIRST SET OF DATA EQUEST
DATED DECEMBER 16, 2003

2. Refer to the Kollen Testimony, pages 14 through 17. Mr. Kollen recommends that the ESMs for Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") should be discontinued.

   a. Mr. Kollen describes what he believes should happen if the ESMs are discontinued in 2004. Is Mr. Kollen recommending that the ESMs be discontinued in 2004.

   b. If yes to part (a), explain why 2004 is the appropriate year for discontinuing the ESMs.

   c. If not to part (a), what year does Mr. Kollen recommend for the discontinuation of the ESMs?

   d. If the ESMs were discontinued in 2004, explain why it would not be reasonable to make the ESM calculations based on calendar year 2003 the last ESM.

   e. Assume for purposes of this question that the ESMs are discontinued in 2004. In performing the ESM calculations for calendar year 2004, would the rate of return on common equity ("ROE") be the 11.5 percent currently included in the mechanism, or would the ROE authorized in the pending general rate cases be utilized? Explain the response.

COMMONWEALTH OF KENTUCKY

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TARIFF OF KENTUCKY UTILITIES COMPANY	**)**	**CASE NO. 2003-0334**
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AN INVESTIGATION PURSUANT TO KRS 278.260	**)**	
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KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO COMMISSION STAFF'S
FIRST SET OF DATA EQUEST
DATED DECEMBER 16, 2003

RESPONSE TO 2

2a. No. Mr. Kollen believes that it would be appropriate to discontinue the ESMs on or before December 31, 2003 on the basis that the base rate filings constitute an effective rejection of the ESM form of regulation. In that event, the last ESM filings would be made in 2004 utilizing the 2003 calendar year as the test year. However, if the ESMs are continued into 2004, it is essential that they continue for the full calendar year and that the rate increases, if any, be annualized for the reasons cited by Mr. Kollen in his testimony.

2b. Please refer to the response to part (a) of this question.

2c. Please refer to the response to part (a) of this question.

2d. Mr. Kollen believes that it would be reasonable to make the last ESM filing in 2004 utilizing the 2003 test year. However, Mr. Kollen is concerned that the Companies may make the legal argument that the ESMs remain in effect, unless and until terminated by the Commission, and that such termination may only be made prospectively. It was for this reason that Mr. Kollen addressed the 2004 test year and the annualization of any rate increases in his testimony.

2e. Mr. Kollen believes that it would be appropriate to utilize the ROE authorized in the pending general rate cases. This treatment would be consistent with the Commission's use of the ROE authorized in the general rate cases in the year in which the ESMs initially were adopted.

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**KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO COMMISSION STAFF'S
FIRST SET OF DATA EQUEST
DATED DECEMBER 16, 2003**

3. Refer to the Kollen Testimony, pages 20 and 21. Mr. Kollen recommends against tying the short-term incentive compensation program to the earnings performance under the ESMs, as recommended by the Barrington-Wellesley Group, Inc. ("BWG") audit report.

   a. Does Mr. Kollen have any suggestions that would address the concern identified by BWG that led to its recommendation to tie the short-term incentive compensation program to the earnings performance under the ESM? Explain the response.

   b. Currently under the ESM, if the ROE calculated as part of the ESM is 100 basis points or more below the threshold, LG&E and KU can collect 40 percent of the shortfall from ratepayers. Would an incentive to address the concern raised by BWG over incentive compensation be to adjust the percentage of any earnings shortfall recovered from ratepayers depending on how far below the ROE calculated under the ESM is below the threshold (for example, if the ROE is 250 basis points or more below the threshold, the collection percentage could be 20 percent)?

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KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO COMMISSION STAFF'S
FIRST SET OF DATA EQUEST
DATED DECEMBER 16, 2003

RESPONSE TO 3:

a. No. Mr. Kollen disagrees with the BWG premise that there is a problem to correct or that the short-term incentive compensation program should be in "alignment" with the ESM program. BWG offered no evidence that linking the short-term incentive compensation program to the earnings performance under the ESMs would result in either improved earnings performance or lower rate increases.

b. No. Please refer to the response to part (a) of this question. Mr. Kollen does not believe there is a problem to correct. In addition, given the fact that the short-term incentive compensation expense is not currently included by the Companies in the computation of the ESM ROE, it would not be appropriate for the Commission to modify the thresholds and sharing percentages on the basis that there is no linkage between the short-term compensation and the earnings performance under the ESMs. Any modifications to the thresholds and sharing percentages of the ESMs should be based on other relevant factors, not this one.

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KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO COMMISSION STAFF'S
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DATED DECEMBER 16, 2003

4. Refer to the Direct Testimony of Carl G. K. Weaver, the Attorney General's witness. Provide any comments or recommendations Mr. Kollen has concerning Dr. Weaver's "Target Equity Component" and "Capital Structure Activation Limit" recommendation.

RESPONSE TO 4:

Mr. Kollen has not reviewed Dr.Weaver's testimony and has no comments or recommendations at this time.

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**KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.
RESPONSE TO COMMISSION STAFF'S
FIRST SET OF DATA EQUEST
DATED DECEMBER 16, 2003**

5. Refer to KU's responses to the Commission Staff's First Data Request dated October 30, 2003, Items 29(f) and (g). KU is seeking approval of the deferral of net ice storm costs for recovery in future rate proceedings before the Commission. Provide any comments or recommendations Mr. Kollen has concerning KU's request to defer the net ice storm costs.

RESPONSE TO 5:

Mr. Kollen agrees with the Commission's Order and its stated rationale for denying the requested deferrals. The Companies' request represented an inappropriate attempt to transform certain identifiable costs eligible for 40% recovery through the ESM to 100% recovery through subsequent base rate filings. The Commission's stated intent in Case Nos. 98-426 and 98-474 was that the ESMs reflect actual costs and revenues except for specific adjustments authorized pursuant to those Orders in those cases. The Companies should not be allowed to circumvent the ESMs every time they incur a significant identifiable cost. Mr. Kollen is not aware that the Companies have filed any requests to defer revenue increases or identifiable cost reductions other than as offsets to requests for related cost deferrals.